Stranded Gas Hearings

(0407281415 Minutes)

Access to Capacity for Alaskan Utilities

Anthony Izzo, President, ENSTAR Natural Gas Company, July 28, 2004.

MR. ANTHONY IZZO, President, Enstar Natural Gas Company, said it has been serving its Alaskan customers for over 40 years. He accompanies his comments with a slide presentation. The first slide showed a fuel cost comparison. Gas was the cheapest. The second slide showed Enstar's pipeline infrastructure; the third slide showed a graph of the Cook Inlet gas supply from 1958 – 2002 and projects out to 2022, when it drops off significantly. A fourth slide showed a graph of consumer's use of Cook Inlet gas.

MR. IZZO explained that Enstar's supply strategy, as it sees production dropping off at the end of the decade, has been two-fold.

> We need to contract for additional supply. The reason it's significant is that we've moved clearly from an excess supply market. Back decades ago – in our business we call it overhang – there was a lot of gas available and the demand was much lower and so the contracts at the time were all indexed against prices of oil. It made sense if oil prices were up, the economy was doing well, your natural gas bill went up. If oil prices were down, the economy was down, your natural gas prices for home heating and business use were down. We were not able to secure additional supply using that model – going back just a couple of years ago. So, what we clearly identified is the fact that we've gone from an excess supply to a supply and demand market.
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> The second strategy was to clearly identify what really is left in the Cook Inlet - is there potential for additional discovery and can the existing reserves be expanded? What is the real situation from our perspective in terms of North Slope gas?

MR. IZZO presented more slides that graphed Enstar's gas supply from different fields and explained:

> With the new strategy, understanding that this was going to be a supply and demand market, we had to look at how we contracted for supply very differently. The good news you'll see on the chart here is that we're now filled up to 2007 and what you see in green is what we refer to as the Unocal contract. It's not indexed against the price of oil; we couldn't get anybody to go and look for that. It's indexed against a trailing average of the Henry Hub. I guess simply put, it is indexed on Lower 48 prices. What we were able to do was to use a trailing 36-month average.
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> We did not want to subject Alaskans to the volatile price swings in the Lower 48. There have been times in California where natural gas prices would be $20 and then it's $6 and then it's $10. We didn't want that to happen because on a monthly or quarterly basis, bills would be changing; you couldn't plan or budget. It was just not something we found acceptable. So, the average allows us to, once a year, make the adjustment to the Regulatory Commission of Alaska and then it gets passed right through. The consumer pays for it and it gets passed through Enstar directly to the producer.
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> So, the good news is that we've got some investment going; we've spurred some exploration. That gas in green right now costs $4.39. Our weighted cost to the consumer is $3.11 and in the Lower 48, they're paying about $6. So, we're less, but prices will increase. As the Unocal gas makes up more and more of our portfolio...we move away from most of the supply being indexed against oil prices, which are up by the way, which means that gas prices will go up next year. But, we will be more and more connected to that Lower 48 pricing mechanism. Unocal has spent about $110 million in looking for new supply and there has been some success we're very pleased about.
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> Step number two is to determine what is really in the Inlet and what are the options...to serve half the state's population in this region. The final report was released July 6; this was done by the Department of Energy as a result of a federal appropriation to the DOE's Arctic Energy Office in

Fairbanks. A local firm in Anchorage actually did the work, brought in outside expertise when needed, and worked with all the various utilities and producers.

There are three observations...in the report that I think are relevant. One is potential reserves growth, two is new exploration and what is the potential and three, North Slope gas to Cook Inlet.

MR. IZZO explained some of the graphs that showed the gas supply line dipping below the demand for power generation and home heating in 2012. His real concern is, looking at fields that are dedicated for just power generation and home heating, that line intersects in 2009.

In terms of reserves growth now, DOE looked at it and said well, we have these existing fields in Cook Inlet. What's the potential if those were to be expanded – if modern technology was used and you enter those fields? So, this is highly speculative. They just used models from other fields around the world that were just as mature.... You might be able to get another 1.5 TCF out of there. Applying some of their information, they came up with a cost of about $.5 billion...to expand those reserves....

What that would look like is a slightly more optimistic slide on the next page. If 1.5 TCF were found in those fields at $500 million, we could be looking at a line that doesn't dip down below until the end of the next decade. And so, it's not a sure thing by any means and there's no guarantee that trying to increase those reserves will actually result in this, but a best case scenario is for $.5 billion, that it might buy us some time to get us through most of the next decade.

In terms of new exploration, they found some good news. I thought it was some good and some not so good. They believe that based on the profile of the endowment in the Cook Inlet, the Department of Energy thinks that there could be 13 – 17 TCF additional in the Inlet and that's great. The concern I have is that once they put some analysis to the cost and we looked at the protected lands, we looked at the cost onshore versus offshore, they found that if you could find 50 percent of that potential gas – again, you're throwing the dice, in my view.... if you found half of it and if it were on land, then the investment required there would be $5 billion to $6 billion. That would certainly buy us a decade or two. The concern I have, again, is the economics.... It would have to be competitive and be passed through to the consumer.

Now, out of my own business interests, what are the alternatives? The alternatives, if it isn't natural gas, there's fuel oil, there's propane, there is electric, but you're talking about three, four, five and six times as much. You're talking about half the state's population in terms of the economic impact. That does not include what it would cost to convert, what it would cost to put in tanks, to convert furnaces, etc.

The last observation I'll share with you from my perspective was the North Slope pipeline ideally did have the potential to moderate prices in Southcentral Alaska. One thing that Enstar knows and that I'm here to share with you is that prices are going to increase. That's a conclusion. I know they will go up, because I couldn't get anybody to go and look for gas unless it was economic to go and look for it. So, the traditional model of all this extra gas and we'll sell it to you at a stranded gas prices. It just didn't work any more. So, they'll go and look, but we could end up by the end of the decade paying more than they do in the Lower 48. It still might be less than the next alternative, but it's not a good situation.

I was very encouraged that the DOE found that a spur could provide a $1 per MCF advantage over the Lower 48 pricing and that that could result in some energy intensive industry and some economic development.... What we're showing here is that gas from the Slope down into the Lower 48, if it cost $2.58 - $3.00 MCF, that using the various models, conservatively the DOE believed that it could be, in comparison, $1.50. So, we could enjoy $1 MCF reduction or a lower price compared to the Lower 48, which could mean with our deep water access and logistical advantages here in Alaska, that we could have an economic advantage. It's not a choice of paying whatever the tariff might be from the Slope to Anchorage versus paying the $2 that we've been paying for years for gas over the decades, because those days are gone. It's going to be at some point in the next few years, we're going to be paying more than the Lower 48, because we're technically not connected to them. But, for producers to economically go after the additional supply, it's the over-ripe fruit story. The low ripe stuff has been picked....

The conclusions are that I believe from Enstar's perspective that access to Slope gas is absolutely critical. As I stated, I believe that prices will continue to rise because we're in this supply and demand market. That has clearly shifted in my world. We could enjoy a 20 - 25 percent price advantage over the Lower 48, which, I think, instead of being concerned about an economic decline associated with declining reserves, we could be looking at some potential economic boom in terms of energy intensive industry. To determine what that is, we have requested a phase-two appropriation to study energy intensive industry, what that might be and to also look at some conceptual engineering for a connection from Anchorage up to Fairbanks or Delta Junction. I've got my commercial blurb at the end and now it's time to focus and I'm preaching to the choir. That concludes my presentation.

SENATOR WAGONER asked if Enstar is still considering a spur line.

MR. IZZO replied that it is.

That is very real and is in the forefront of our radar screen in the future. We believe that we have obvious interest in wanting to stay in business and wanting to be profitable, wanting to earn our rate of return that's allowed, but we have found that with the declining reserves in Cook Inlet that our interests are similar and parallel with the economic interests of this region. So, I would use the example of building a house. I don't think any of us, if we were building a home, would wait until the framing was up to pull out the yellow pages and find an electrician or a plumber. We'd have the estimates; we would know what it would cost. We'd have it ready to go and that's how we view the spur line – is that we need to know what that is and we are currently working such that we can do the responsible thing and be prepared.

REPRESENTATIVE GARA asked of the gas pipeline owner's incentive not to allow a spur to Cook Inlet:

If they fill up the pipeline from the North Slope down to Tok, and then dump off a certain amount of gas in Tok, then that they're carrying a less than full pipeline from Tok all the way down to Chicago and therefore it makes the transportation in the remainder of the line less efficient? Do they have a disincentive to allow the spur because of that and also because it eats into the amount of gas they get to charge to pipe from Tok down to Chicago? Is that the disincentive or does the pipeline not work that way? Two, do you agree with Attorney General Cole that we have to take another look at the law to make sure that we guarantee our ability to have the spur lines in the state?

MR. IZZO agreed on his first point. Various interested parties have expressed concern to him directly that constructing a pipeline with X capacity and then finding themselves in a situation where only 75 percent or so of that capacity can be met from Tok or Delta Junction on south. My response to that has been more around what the needs of this community are as I know them.

MR. IZZO explained that when the interested parties hear of the need for power generation and, potentially, some industrial use and home heating, which is much less than 1 BCF per day, the reaction has been one of reassurance. To Representative Gara's second point, he said he did not hear Mr. Cole's presentation, but, "The legal nature and critical need of a spur line in my view is something that we should do every bit of due diligence possible. So, if there's any doubt that we may have access, I would encourage the legislature or any responsible party to look at that."

CO-CHAIR OGAN suggested that Mr. Izzo review Mr. Cole's presentation, which has some very good points about Fairbanks' concerns with the take and pay concept in HB 290 of the 21st Legislature.

REPRESENTATIVE CHENAULT said Mr. Izzo talked about the price of new gas from Unocal being $4.39, which is based on some sort of sliding scale at the Henry Hub, and he projects the price will go up because of the price of oil. He asked him how he is tying the price of oil back to the price of gas when it is based on a sliding scale at the Henry Hub.

MR. IZZO referred to the slide of the gas supply in 2003 and said he refers to those contracts as legacy contracts. Those have been indexed, for some time now, on the price of West Texas sweet crude between May 1 and June every year. Based on that index, prices will change in the following calendar year. He continued:

> So as we've moved into where we are here in 2004, 24 percent of my supply is with the Unocal contract. That's indexed against the trailing average of Henry Hub. The remainder is still indexed on the price of oil so what's happening currently is within this transitionary period, is the price of oil is up. That is putting upward pressure on rates. As the prices are sustained at high levels in the Lower 48, that drives that average up over the 36 month trailing period....

CO-CHAIR OGAN responded:

> Once we indexed to the Henry Hub, the consumer prices went up quite a bit based on that – is what's going to have to happen to have people looking for gas, which we do have finally for the first time ever. People are leasing for the sole purposes of looking for gas in Cook Inlet and that was just something that happened with oil before that.

REPRESENTATIVE HARRY CRAWFORD said that he and Senator Bunde attended a NCSL conference and heard a presentation by the producers, during which they talked about the energy supplies in the country over the next 25 years. They said they don't even book the North Slope gas supplies in because they expect those supplies to be stranded for another 25 years. He asked Mr. Izzo what will happen to Enstar if that gas supply does not come off of the North Slope.

MR. IZZO said Enstar has been undergoing a very aggressive program. It has and continues to meet with producers on an ongoing basis. Enstar believes it is responsible to determine what it will take to spur exploration. It would continue as it has and, although there is a certain amount of uncertainty about the future compared to 20 years ago. He then said he does not subscribe to the 25-year theory. He believes that with free market forces, this is something that can happen. He has discussed that question with his peers throughout the country and has asked, at Western Energy Institute Board meetings, how many of them would have a difficult time getting a long term supply approved at $4 or $4.50 by their commissions and everyone had jumped up. He said he sees the need for some reassurance of supply and, to some degree, it is a national security issue. He said because of the volatility his cohorts are experiencing, they would embrace the ability to reserve capacity. He said the true test would be the number that would line up if there was an open season.

MR. IZZO said this has been discussed for almost 35 years and he is asked what is different now. As he looks at half of the state's population that could see declining reserves, he sees how that is directly associated with Alaska's economy and yet, Alaska is the richest resource state in the Union. He thinks with the confluence of those factors and free market forces, this is a very viable project.

CO-CHAIR OGAN noted that every expert on energy supply and demand trends who spoke to the Energy Council in the last year and a half factored in the availability of Alaska gas and that beyond the year 2020, the United States will have to import 20 percent of its gas from foreign LNG sources even with 4.5 BCF from Alaska. He asked Mr. Izzo to visit the Mat-Su Borough and relay his views on the gas supply.